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SENSITIVE

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TAGS: ECON EFIN ETRD EINV PGOV EAGR GT
SUBJECT: DEBT DEAL WITH SPAIN CLEARS WAY FOR CREDIT UPGRADE

¶1. (U) The GOG and the Spanish government (GOS) signed an agreement on January 11 laying out the terms for forgiveness of the twenty-six year old debt that has hampered the bilateral relationship and complicated Guatemala's treatment in multilateral financial forums. The deal involved direct payment of a small portion to private creditors, further payments to a development fund to be managed by the Spanish in Guatemala, and a triangular debt arrangement involving Nicaragua. The 1980 debt dispute has been a priority for the Berger Administration, which has been working to improve Guatemala's international image and credit ratings. The Spanish began negotiating the deal as their bilateral relationship improved in 2001, but only moved to close the deal now, in part a reflection of their confidence in the Berger administration. End Summary.

The Debt

¶2. (U) Spain's public export bank backed a 1980 loan to the private Guatemalan company, Corfina. The $188 million loan, guaranteed at the time by the GOG, financed construction of a paper mill in El Progreso. Soon after, the company defaulted on the loan and the GOG refused to cover it. With interest and penalties, the debt carried on the books of the GOS and Spanish private sector creditors, who eventually bought the debt, grew to almost $1 billion by early 2001. The debt prohibited the GOG from participating in Spain's bilateral financial assistance programs. It also held down Guatemala's credit rating in the OECD, which has follow-on implications in a variety of private sector credit ratings.

The Deal

¶3. (SBU) EconOff met with Carlos Merino, the Economic Counselor at the Spanish Embassy in Guatemala. According to Merino, the GOS-GOG bilateral relationship had been difficult since the burning of the Spanish Embassy in 1982 during the civil war. However, in 2001, some progress on this and other issues led to a renewed effort by both sides to come to an agreement on the outstanding debt. Then Finance Minister Eduardo Weymann proposed a triangular deal involving $506 million in Nicaraguan debt owed to the GOG. The GOG transferred the Nicaraguan debt to the GOS in exchange for forgiveness of much of Guatemala's debt to Spain. The Spanish preferred the Nicaraguan debt as it could be dealt with in Paris Club negotiations and ultimately forgiven on better terms, as Nicaragua is a HPIC country (Guatemala is not). This creative approach significantly advanced the negotiations, but the general breakdown of the Portillo administration and its overwhelming corruption stalled further progress on the debt talks. Difficulties in liquidating the largely out-of-date paper mill further complicated negotiations.

¶4. (SBU) When President Berger took office in January 2004, the Spanish were increasingly motivated to remove this long-standing impediment to the bilateral relationship as a signal of confidence in the new government. On the Guatemalan side, a group was formed to improve Guatemala's image and international credit ratings. The mixed public-private sector group has been lead by Commissioners for Government Planning, Richard Aitkenhead and for Competitiveness, Mickey Fernandez, along with Banco Industrial President, Luis Prado. They met with EconOffs on several occasions in an effort to lobby for USG support for improved credit ratings for Guatemala. They brought their case directly to the OECD, Ex-Im representatives, Moody's, and Standard and Poor's and heard from several fronts that the outstanding debt with Spain was holding back the country's rating.

¶5. (U) The deal signed on January 11 and announced at a press conference on January 16 involved a $10 million payment to be made over the next 60 days to the private Spanish creditors (covered by the final sale of the Corfina facility); $10.5 million to be paid into a development fund that the Spanish will administer in Guatemala over the next three years to support health and education projects; and forgiveness of the

remainder of outstanding debt not covered by the 2001 Nicaragua deal. The Spanish Embassy is now working to develop financial assistance programs for Guatemala, the only country in the region that doesn't currently benefit from such programs.

Comment: A Good Win for Berger's Economic Team
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¶6. (SBU) The Guatemalans anticipate increased cooperation with the GOS and are happy to have this black mark removed from their international reputation. More importantly, the GOG and the big financial sector players are optimistic that they will now be able to raise Guatemala's credit rating; thereby reducing public and private interest rates and attracting more direct investment. Guatemala is still ranked below most of their neighbors in spite of their impressive macro-economic indicators and low debt levels. However, they may be overselling the importance of their OECD ratings. Impressively low debt levels not only reflect years of fiscal restraint, but also the GOG's historic under-investment in Guatemala's people and infrastructure. Attracting much-needed direct investment will require the long-term success of Berger's business climate and social investment initiatives.

DERHAM